

FILED³

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**Missouri Public
Service Commission**

Exhibit No.:

Issue(s):

Witness:

Sponsoring Party:

Type of Exhibit:

Case No.:

Date Testimony Prepared:

110

*Rate of Return and
Capital Structure*

Dave Murray, CFA

MoPSC Staff

Surrebuttal Testimony

WR-2018-0170

August 3, 2018

MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

FINANCIAL ANALYSIS DEPARTMENT

SURREBUTTAL TESTIMONY

OF

DAVID MURRAY, CFA

**LIBERTY UTILITIES (MISSOURI WATER) LLC,
d/b/a LIBERTY UTILITIES**

CASE NO. WR-2018-0170

*Jefferson City, Missouri
August 2018*

Exhibit No. 110

Date 8-16-18 Reporter TTT

File No. WR-2018-0170

Surrebuttal Testimony of
David Murray, CFA

1 Q. What is the basis for Mr. Stannard's recommendation?

2 A. Mr. Stannard adds Duff & Phelps' estimated equity risk premium of 5% to a
3 spot 30-year Treasury yield of 2.97% to estimate a required return on common equity of
4 approximately 8%. Mr. Stannard then adds 100 basis points to this base to allow for a range
5 of 8% to 9%.

6 Q. Is Duff & Phelps an authoritative source as it relates to estimating the cost
7 of capital?

8 A. Yes. Staff consistently relies on this source for purposes of testing the
9 reasonableness of its own cost of equity estimates. Duff & Phelps publishes a comprehensive
10 amount of data that assists financial analysts with estimating the cost of capital. Duff &
11 Phelps assesses equity risk premium estimates derived using a variety of
12 methods/sources/data, such as historical earned return spreads between stocks and bonds and
13 implied equity risk premiums estimated by various authoritative sources, such as academics
14 and investors.

15 Q. Does Mr. Stannard apply Duff & Phelps' suggested equity risk premium as
16 Duff & Phelps' intends it to be applied?

17 A. No. Mr. Stannard applies the equity risk premium to a spot 30-year Treasury
18 yield. Duff & Phelps' equity risk premium estimate is conditioned on a "normalized"
19 risk-free rate of 3.5%. Adding the 5% conditional equity risk premium to this yield results in
20 a market cost of equity of 8.5%.

21 Q. Did Mr. Stannard leave out a step to adjust the equity risk premium to reflect
22 the fact that utility stocks are less volatile than the broader markets?

Surrebuttal Testimony of
David Murray, CFA

1 A. Yes. Utility stocks are less volatile than the broader market. This lower
2 volatility is typically measured by calculating the beta of utility stocks. Typically, betas of
3 utilities are in the range of 0.6 to 0.8. Applying a typical utility beta of 0.7 to the market risk
4 premium of 5%, results in an industry adjusted risk premium of 3.5%. Adding this 3.5%
5 adjusted risk premium to Duff & Phelps' normalized risk-free rate of 3.5% results in a cost of
6 equity of 7%.

7 Q. If using authoritative sources in conjunction with widely-accepted cost of
8 equity methods implies a cost of equity of 7%, why did you recommend a 10% allowed ROE
9 for both Liberty Water and Liberty Midstates?

10 A. Because I am using the Commission's previous decisions as guidance as to a
11 fair and reasonable allowed ROE, giving its most recent allowed ROE of 9.8% in the
12 Spire Missouri gas rate cases, Case Nos. GR-2017-0216 and GR-2017-0217, the most weight.
13 Being that Liberty Water has a more leveraged capital structure than that authorized
14 Spire Missouri, Staff recommended a 20 basis point increase to the allowed ROE. Staff
15 quantified the 20 basis point adjustment by evaluating recent spreads between 'BBB' rated
16 bonds and 'A' rated bonds. For more detail, please see pages 47-48 of my "Detailed Direct
17 Testimony" filed in the Liberty Midstates rate case.

18 Q. Does this conclude your Surrebuttal Testimony?

19 A. Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In The Matter of the Application of Rate Increase for)
Liberty Utilities (Missouri Water), LLC d/b/a)
Liberty Utilities) Case No. WR-2018-0170

AFFIDAVIT OF DAVID MURRAY, CFA

State of Missouri)
) ss
County of Cole)

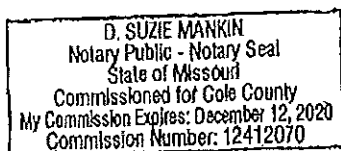
COMES NOW David Murray, CFA, and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Surrebuttal Testimony*; and that the same is true and correct according to his best knowledge and belief. Further the Affiant sayeth not.




David Murray, CFA

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 2nd day of August, 2018.





NOTARY PUBLIC